United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

77-7183

ORIGINAL

To be argued by
CLARENCE FRIED

UNITED STATES COURT OF APPEALS
FILED
OCT 25 1977
A. DANIEL FUSARO, CLERK
SECOND CIRCUIT

United States Court of Appeals
FOR THE SECOND CIRCUIT

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

against

TOUCHE ROSS & Co.,

Defendant-Appellee.

REPLY BRIEF OF PLAINTIFF-APPELLANT SECURITIES INVESTOR PROTECTION CORPORATION

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REPLY BRIEF OF PLAINTIFF-APPELLANT SECURITIES INVESTOR PROTECTION CORPORATION

Preliminary Statement

Plaintiff-appellant Securities Investor Protection Corporation ("SIPC") submits this brief in reply to the answering brief of defendant-appellee Touche Ross & Co.

In seeking to convince this Court not to recognize a right of action under Section 17 of the Securities Exchange Act of 1934 ("the 1934 Act") in SIPC's behalf (both in its own right and as the subrogee of Weis' customers), Touche Ross relies heavily on *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977) and also makes repeated references to the purported relevance of Section 18 of the 1934 Act to Section 17. However, the reliance on *Piper* is misplaced and the references to Section 18 are misguided because, for all its length, Touche Ross' brief simply does not—and cannot—refute that:

—SIPC (unlike the plaintiff in *Piper*) is not a member of the class whose activities Congress sought to regu-

late, and SIPC's subrogors (again unlike the plaintiff in *Piper*) are the members of the very class Congress intended to protect; and

—Section 18, like Section 13 to which the cases cited by Touche Ross refer, is not addressed to the purpose which Congress intended Section 17 to serve: to protect investors from the financially unsound broker-dealers to whom they might entrust their cash or securities.

This reply brief will demonstrate that:

(1) The recognition of a Section 17 right of action for SIPC is strongly supported by *Piper,* as well as by other pertinent decisions (pp. 3-10, *infra*);

(2) The purchaser-seller requirement of Section 18 may not be engrafted into Section 17 in the context of this case (pp. 16-19, *infra*);

(3) Touche Ross errs in asserting that SIPC does not stand in the shoes of those customers of Weis whose claims have been satisfied through the depletion of the SIPC fund (pp. 10-15, *infra*); and

(4) Touche Ross errs in contending that Section 17 imposes no duty on accountants such as itself, and indeed, Touche Ross may be liable for its breach of its Section 17 duty (pp. 20-22, *infra*).

This brief will not address itself to Touche Ross' belabored and hardly compelling argument that this action, which arises from an accountant's participation in and facilitation of a multi-million dollar fraud perpetrated upon the investing public in violation of Section 17 of the 1934 Act (as to which federal court jurisdiction is exclusive), should be relgated to state court. That argument is disposed of in the reply brief of the Trustee.

ARGUMENT

POINT I

A right of action under Section 17 should be implied in favor of SIPC in its own right.

As amply explained in SIPC's main brief (SIPC Br. 17-19, 30-32, 42-45, 47-48), it is absolutely essential to SIPC's ability to effectively carry out its role in the statutory and regulatory scheme devised for the protection of the customers of broker-dealers that the Section 17 reports certified by accountants such as Touche Ross be accurate. Simply put, SIPC relies on those reports. But, contrary to Touche Ross' mischaracterization, SIPC does *not* merely contend here that "anyone who might rely upon a defendant's compliance with the 1934 Act or suffer injury due to lack of such compliance may assert an implied private right of action" (TR Br. 56). The reasons for recognizing a right of action under Section 17 in favor of SIPC, in its own right, are far more compelling than Touche Ross would have this Court believe.

A. SIPC Is In A Virtually Unique Position In Relation To Section 17.

First of all, SIPC is not just "anyone." SIPC is a quasi-governmental organization created by Congress to enhance the mechanism, set into motion by the 1934 Act, for the protection of the customers of broker-dealers. And the SEC has "plenary authority" to supervise SIPC's operations. *SIPC* v. *Barbour*, 421 U.S. 412, 417 (1975); SEC Br. 3-4. Indeed, in light of SIPC's governmental nexus, SIPC is actually seeking to enforce considerably more than a common "private" right of action under Section 17. Not surprisingly therefore, the SEC has submitted an *amicus curiae* brief to this Court in which it states that it believes that "permitting a private right of action under Section 17

of the Securities Exchange Act will provide a necessary supplement to the Commission's efforts to enforce that section and the rules and regulations thereunder" (SEC Br. 3). Thus, here, as in *J. I. Case* v. *Borak,* 377 U.S. 426, 432 (1964), "[p]rivate enforcement provides a necessary supplement to Commission action." *See also, Piper, supra,* at 25.

Moreover, the reliance by the regulatory agencies (and thus by SIPC) on the Section 17 reports is so total that, where those reports are false and misleading (as were those certified by Touche Ross), the possibility of timely remedial action (*e.g.,* infusion of new capital, merger, *etc.*) to avoid the forced liquidation of a broker-dealer is frustrated. *SIPC* v. *Barbour, supra,* at 421-422; SIPC Br. 30-32, 42-43. Thus, the consequence of the deception by the accountant's certification is just such a forced liquidation as Weis is currently undergoing—a liquidation which, in addition to costing SIPC fourteen million dollars, has cost Weis' customers and creditors (to the extent that their claims have not been fully satisfied by SIPC) millions of dollars more. In other words, the harm done as a result of the deception perpetrated by Touche Ross is far more pervasive than the substantial damages which SIPC alone has suffered. Had the regulatory agencies (and thus SIPC) learned of Weis' true financial condition in 1972, that harm could have been greatly reduced, if not obviated.

B. SIPC Is Not A Member Of The Class Congress Intended To Regulate By Section 17.

Most significantly, SIPC is not a member of the class Congress intended to regulate by Section 17. Instead, SIPC is itself an integral part of the scheme designed by Congress, through the enactment of the 1934 Act and the Securities Investor Protection Act of 1970 ("SIPA"), for the protection of the customers of broker-dealers.

In arguing that SIPC may not assert Section 17 claims in its own behalf, Touche Ross relies on *Piper, supra,* and

Lank v. *New York Stock Exchange,* 548 F.2d 61 (2d Cir. 1977) (TR Br. 56). However, the marked contrast in status between the plaintiffs in those cases and SIPC here only emphasizes that a cause of action in SIPC's behalf should be implied. In both *Piper* and *Lank,* the plaintiffs were themselves members of the class Congress intended to regulate by the very statute under which they urged that a right of action should be implied in their favor.* Of course, the same can hardly be said of SIPC's relationship to Section 17.

It is one thing for a tender offer combatant to sue its adversary, by invoking a statute meant to protect the shareholders who are the subject matter of the combat (*i.e., Piper*); or for a member of a stock exchange to sue his association for its failure to properly oversee the improper conduct of the constituent member, by invoking a statute meant to protect the member's customers (*i.e., Lank*). It is an entirely different matter when a quasi-governmental organization such as SIPC sues an accountant by invoking

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* As the Supreme Court noted in *Piper, supra,* at 37:

"... Chris-Craft [the plaintiff] is a member of the class whose activities Congress intended to regulate for the protection and benefit of an entirely distinct class, shareholders-offerees. As a party whose previously unregulated conduct was purposefully brought under federal control by the statute, Chris-Craft can scarcely lay claim to the status of 'beneficiary' whom Congress considered in need of protection."

Similarly, this Court stated in *Lank, supra,* at 66:

"... we conclude that it was the intention of Congress to draw a clear line of demarcation between public investors, on the one hand, who may assert claims against a stock exchange for damages arising out of violations of Section 6, and, on the other hand, members of those exchanges, who may not. The Congress did not enact Section 6 for the purpose of affording protection to the very members of the stock exchanges whose conduct was being regulated at the expense of those exchanges. We therefore hold that a securities exchange is not liable to a member organization for failure to force the member to comply with the exchange's rules."

a statute (*i.e.*, Section 17) compliance with which by the accountant is essential to the effectiveness of that organization in safeguarding the interests of the class (*i.e.*, the customers of broker-dealers) which that statute was expressly meant to protect.

Moreover, again in marked contrast to *Piper*, the recognition of a right of action under Section 17 in SIPC's own right would "confer [an] advantage on the expressly protected class". *Piper, supra,* at 38. In this regard, this Court should note the SEC's concern that "SIPC have the ability to recover funds needlessly expended due to the wrongful acts of others, thus preserving the funds available to compensate losses suffered by the customers of broker-dealers" (SEC Br. 4). In view of the fact that any moneys restored to the SIPC fund would be for the benefit of the protected class, it simply cannot be stated here, as it was in *Piper* that "a damages award . . . may well be inconsistent with the interest of many members of the protected class. . . ." *Piper, supra,* at 42.

Because of SIPC's quasi-governmental status and because SIPC is anything but a member of the class Section 17 is intended to regulate, a Section 17 right of action should be implied for SIPC in its own right.*

POINT II

A right of action under Section 17 should be implied in favor of SIPC as the subrogee of Weis' customers.

Touche Ross does not question, as it cannot, that Section 17 was intended to protect the customers of broker-dealers. Yet, Touche Ross seeks to deprive those customers

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* In addition to the foregoing reasons for recognizing a right of action under Section 17 in SIPC's own right, this Court is reminded that SIPA renders SIPC a direct beneficiary of the protection afforded by Section 17 (SIPC Br. 42-43, 47).

of a right of action under Section 17, and contends further than SIPC may not be subrogated to their claims even if they had a right of action.* As shown immediately below, Weis' customers are manifestly entitled to the implication of a Section 17 right of action, and SIPC may indeed step into their shoes to assert those claims which they could have asserted had those claims not been satisfied through the depletion of the SIPC fund.

A. Weis' Customers Are Members Of The Class Section 17 Is Intended To Protect And A Right Of Action Thereunder Should Be Implied In Their Behalf.

As noted, even Touche Ross does not dispute that Section 17 was intended to protect the customers of broker-dealers such as the ones to whose claims SIPC asserts that it is subrogated. The Supreme Court's decision in *Borak*, as recently reaffirmed by its decision in *Piper*, rebuts any possible contention that a right of action may not be implied in behalf of the members of the very class Congress intended to protect by the statute under which the implication is sought. *Borak, supra,* at 432; *Piper, supra,* at 32-33.**

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* Touche Ross also contends that: (1) because Weis' customers were not purchasers or sellers of Weis' stock and cannot meet the requirements of Section 18, a right of action in their behalf may not be implied, notwithstanding the fact that Section 17 was intended to protect them *qua* customers of a broker-dealer to whom they entrust their cash or securities and not *qua* purchasers or sellers of an issuer's securities; and (2) that an accountant such as Touche Ross owes no duty to anyone under Section 17, despite the explicit requirement of Rule 17a-5 thereunder that an accountant certify the Section 17 reports. The lack of merit of these two contentions will be demonstrated, respectively, under Points III and IV, *infra*, of this brief.

** While the Supreme Court in *Piper*, in footnote 28 at 42, stated that "[w]hether shareholders-offerees, the class protected by § 14(e), have an implied cause of action under § 14(e) is not before us, and we intimate no view on the matter", it seems ap-

(footnote continued on following page)

That the implication of a Section 17 right of action in Weis' customers' behalf is fully consonant with the factors set forth in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), has already been adequately argued (SIPC Br. 45-50; SEC Br. 5-29) and need not be reiterated here, except insofar as to point out that the legislative history of Section 17 contains nothing expressing any Congressional intent to *deny* a private right of action thereunder—a fact Touche Ross does not dispute.* As the Supreme Court stated in *Cort, supra,* at 82:

> ". . . in situations in which it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private cause of action, although an explicit purpose

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(footnote continued from preceding page)

parent from the Court's repeated references to the fact that the plaintiff was not a member of the protected class, but rather, was a member of the regulated class, that the Court would have been far more willing to recognize a right of action in behalf of shareholders-offerees, the class expressly protected by Section 14(e). Indeed, Justices Stevens and Brennan stated in their dissent that

> "No one seriously questions the premise that Congress implicitly created a private right of action when it enacted § 14(e) in 1968. Also beyond serious question is the proposition that the members of the class which Congress was especially interested in protecting may invoke the private remedy. . . ."

and noted in the accompanying footnote that the question is not "*whether* the statute created an implied private remedy", but rather, "*who* may invoke that remedy". (emphasis in original) *Piper, supra* at 55.

* Touche Ross merely argues that the enactment of Section 18 somehow evinces a Congressional intent to restrict Section 17 causes of action to those who satisfy Section 18's purchaser-seller requirement (TR Br. 21-24, 29-30, 48). As discussed under Point III, *infra,* Touche Ross' contention is erroneous, and moreover, it is unsupported by any legislative history indicating that Congress considered, but decided against, permitting a cause of action under Section 17 in behalf of the customers of broker-dealers.

> to *deny* such cause of action would be controlling." (emphasis in original)

Because the legislative history of Section 17 is silent on the question of remedies, the *purpose* of Section 17 becomes determinative of that question.* Given the paramount fact that Weis' customers are members of the class for whose especial benefit Section 17 was enacted, this case presents an instance "where congressional purposes are likely to be undermined absent private enforcement [and therefore a] private remed[y] may be implied in favor of the particular class intended to be protected by the statute." *Piper, supra,* at 25. Indeed, failure to imply a remedy in Weis' customers' behalf would warrant the observation this Court made in *Goldstein* v. *Groesbeck,* 142 F.2d 422, 427 (2d Cir. 1944), *cert. denied* 323 U.S. 737 (1944):

> ". . . a denial of a private right of action to those for whose ultimate protection the legislation is intended leaves legislation highly publicized as in the public interest in fact sadly wanting, and even delusive, to that end."

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* In view of the absence of a discussion of legislative history concerning remedies in *Borak,* apparently the legislative history of Section 14(a) was also silent on the question of remedies. Thus, the Supreme Court in *Borak* (unlike the District Court in the case at bar) looked to the language and clear purpose of Section 14(a) and recognized (as this Court should with respect to Section 17) that "among its chief purposes is 'the protection of investors', which certainly implies the availability of judicial relief where necessary to achieve that result." *Borak, supra,* at 432. Incidentally, it should be noted that already in *Borak* (decided in 1964), the Supreme Court used the word "necessary," and accordingly, Touche Ross' inference (TR Br. 33-34) from the use of that word in *Piper* that the Supreme Court has recently adopted some new and more stringent "necessity standard" is unfounded. In any event, as discussed throughout SIPC's main brief, it is just as "necessary" that a right of action be implied here as it was in *Borak,* or for that matter, as it might have been in *Piper* had the plaintiff there been a shareholder-offeree or his subrogee.

See also, Charles Hughes & Co. v. *SEC,* 139 F.2d 434, 438 (2d Cir. 1943), *cert. denied* 321 U.S. 786 (1943) and *Baird* v. *Franklin,* 141 F.2d 238, 244 (2d Cir. 1944), *cert. denied* 323 U.S. 737 (1944)—both warning that judicial decisions circumventing the basic protections of a statute "leave such legislation little more than a snare and a delusion."

B. SIPC Is Subrogated To The Claims Which Weis' Customers Whose Claims Have Been Satisfied Through The Depletion Of The SIPC Fund Could Have Asserted Against Touche Ross.

Having made payments to satisfy the claims of Weis' customers, SIPC—by virute of the common law principle of equitable subrogation—steps into the shoes of those customers and acquires the rights which they could have asserted against Touche Ross. Touche Ross contends that SIPC may not be the subrogee of Weis' customers (TR Br. 59-62). That contention is without merit.

The law of New York concerning subrogation was recently summarized in *Salzman* v. *Holiday Inns, Inc.,* 48 A.D.2d 258, 262, 369 N.Y.S.2d 238, 243 (4th Dept. 1975):

> "A right of subrogation may arise when one party uses his money to discharge the obligation of another to a third person. In such case the person who actually paid the debt steps into the shoes of the person paid and acquires his rights as against the one whose debt was discharged by the subrogee (57 N.Y. Jur., Subrogation § 1; Restatement of Restitution, § 162). *The essential element to acquiring a right of subrogation is that the person seeking subrogation must have made a payment, or had his funds or other property applied to discharge another's obligation (Gerseta Corporation* v. *Equitable Trust Company,* 241 N.Y. 418; *American Sur. Co.* v. *Palmer,* 240 N.Y. 63)." (emphasis added)

"Subrogation is a highly favored remedy and the [New York] courts are inclined to extend rather than restrict its application." *King* v. *Pelkofski*, 24 A.D.2d 1003, 1004, 266 N.Y.S.2d 61, 64 (2nd Dept. 1965). *Accord, 3105 Grand Corp.* v. *City of New York*, 288 N.Y. 178, 182, 42 N.E.2d 475, 477 (1942). Thus, to deny SIPC the right to be subrogated to customer claims against Touche Ross would be inconsistent with the law of New York and contrary to the equitable principles upon which that law is based.

This is particularly so in view of the fact that the payments to Weis' customers which caused the depletion of the SIPC fund were compelled by Section 78fff of SIPA. As was stated in *Gerseta Corp.* v. *Equitable Trust Co.*, 241 N.Y. 418, 425-26, 150 N.E. 501, 504 (1926):

> "Subrogation, an equitable doctrine taken from the civil law, is broad enough to include every instance in which one party pays a debt for which another is primarily answerable and which in equity and good conscience should have been discharged by the latter, *so long as the payment was made either under compulsion* or for the protection of some interest of the party making the payment, and in discharge of an existing liability." (emphasis added)

Accordingly, "justice, equity and good conscience" dictate that Touche Ross discharge the obligations it would owe to Weis customers and now owes to SIPC. *See, e.g., Pittsburgh-Westmoreland Coal Co.* v. *Kerr*, 220 N.Y. 137, 144, 115 N.E. 465, 467 (1917); *Bonham* v. *Coe*, 249 A.D. 428, 439, 292 N.Y.S. 423, 435 (4th Dept. 1937); *3105 Grand Corp.* v. *City of New York, supra.*

Touche Ross, however, argues that Section 78fff(f)(1) of SIPA, which provides that SIPC shall be subrogated to customer claims against the debtor's estate, is SIPC's exclusive subrogation right. Of course, were SIPC's statutory subrogation right enacted in derogation of SIPC's

common law subrogation right, SIPC would not be subrogated to customer claims against third parties such as Touche Ross. But, contrary to Touche Ross' contention, the statutory right does not at all eliminate the common law right.*

Indeed, SIPA itself negates Touche Ross' contention because Section 78bbb provides:

> "Except as otherwise provided in this Act, the provisions of the Securities Exchange Act of 1934 apply as if this act constituted an amendment to, and was included as a section of, such Act."

And the 1934 Act, into which SIPA is thus incorporated, provides in Section 28(a):

> *"The rights and remedies provided by this title shall be in addition to any and all rights and remedies that may exist at law or in equity. . . ."* (emphasis added)

Manifestly then, SIPC's common law subrogation right is not abrogated by SIPA. The statutory subrogation right is simply available *in addition* to SIPC's common law subrogation right.**

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* Touche Ross erroneously states that the SEC concedes that SIPC's only subrogation right is the one provided by the statute (TR Br. 59). In fact, the SEC's position is that SIPC "succeeds to *whatever* rights the customer of a broker or dealer may have pursuant to Section 17 of the Securities Exchange Act and the rules thereunder" (emphasis added, SEC Br. 13).

** Section 78fff(f)(1) must be viewed in context in which it appears. It is a subsection of Section 78fff which is headed "Liquidation Proceedings" and contains a detailed and complete blueprint for the distribution of the liquidated SIPC member's estate. Section 78fff is so comprehensive in fact that Congress apparently considered it appropriate to explicitly include a provision that SIPC will be subrogated to customer claims against the liquidated broker-dealer's estate. In direct contrast, no comprehensive scheme is contained in SIPA with respect to customer

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Moreover, by invoking the *expressio unius* doctrine to contend that SIPC's common law subrogation right is impliedly rescinded by the statutory right, Touche Ross overlooks that "[i]t is a cardinal principle of construction that repeals by implication are not favored." *United States* v. *Borden Co.*, 308 U.S. 188, 198 (1939).*

The Supreme Court, in discussing the *expressio unius est exclusio alterius* and *ejusdem generis* doctrines, has also stated:

> "However well these rules may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that *courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.*" (em-

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rights *outside* the context of liquidation proceedings. Accordingly, there was no need to define by statute the subrogation right to which SIPC would be entitled under the common law. The common law right of Weis' customers to sue Touche Ross is obviously not abrogated by SIPA; indeed, Section 78fff(g) recognizes that customers may have common law rights against third parties which are assignable to the trustee in liquidation. *Cf., Securities & Exchange Commission* v. *Albert & Maguire Securities Co., Inc.*, CCH Fed. Sec. L. Rep. ¶ 96,129, p. 92,876 (3d Cir. 1977). Just as the common law right of customers to sue third parties is preserved by SIPA, SIPC's common law subrogation right is also preserved.

* The New York courts have also recognized that, as a rule of construction, statutes are not to be deemed to abrogate the common law unless the intention to do so is obvious. *Dean* v. *Metropolitan Elevated Ry. Co.*, 119 N.Y. 540, 547, 23 N.E. 1054, 1055 (1890); *People* v. *Morton*, 284 A.D. 413, 132 N.Y.S.2d 302 (2nd Dept. 1954), *aff'd* 308 N.Y. 96, 123 N.E.2d 790 (1954); *Long Island R. R. Co.* v. *State of New York*, 1 Misc.2d 781, 785, 148 N.Y.S.2d 711, 716 (Ct. Cl. 1956) ("The common law must be held no further abrogated than the clear import of the [statutory] language used absolutely requires.").

phasis added) *Securities & Exchange Commission* v. *Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943).

In this regard, it should be noted that SIPA evinces a clear Congressional intention that SIPC recapture its expenses to the fullest extent possible.* Thus, it is the "generally expressed legislative policy" to maximize SIPC's recovery of the funds it expends in the course of broker-dealer liquidations. The restrictive view of SIPA's subrogation provision urged upon this Court by Touche Ross would impermissibly contravene that policy.

Finally, considerations of public policy dictate that SIPC should be able to recoup its losses by stepping into the shoes of Weis' customers. This Court should note at least three such considerations. First and foremost, the SIPC fund was not intended to be a windfall benefiting wrongdoers such as Touche Ross. If, prior to the enactment of SIPA, Touche Ross would have been liable for damages resulting from its wrongdoing, it certainly should not be allowed to take advantage of the SIPC fund created by that Act to escape liability. Obviously, Congress did not make SIPA the law of the land for Touche Ross' benefit. A second consideration is that the SIPC fund is not a bottomless pit. Should that fund ever be exhausted, SIPC

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* For example, SIPA Section 78fff(c)(2)(B)(i) provides:

> ". . . *there shall be repaid to SIPC, in priority to all other claims payable from such single and separate fund,* the amount of all advances made by SIPC to the trustee to permit the completion of open contractual commitments. . . ." (emphasis added)

Likewise, SIPA Section 78fff(c)(2)(B)(ii) provides:

> ". . . all costs and expenses specified in clauses (1) and (2) of section 64a of the Bankruptcy Act shall be paid from such single and separate fund in priority to the claims of such single and separate class of creditors, and *any moneys advanced by SIPC for such costs and expenses shall be recouped as such.* . . ." (emphasis added)

And of course, Section 78fff(f)(1), far from abrogating SIPC's common law subrogation right, is yet another example of Congress' concern that SIPC recoup any losses it can.

would have to do that which it has thus far successfully avoided: use its billion dollar line of credit to the federal Treasury to borrow money. (See Section 78ddd(c) and (h) of SIPA.) Lastly, depletion of the SIPC fund postpones the reaching of the $150,000,000 goal prescribed for that fund. (See Section 78ddd(d)(1)(B) and 2(B) of SIPA.) As a result, SIPC's members—most of the broker-dealers in this country—would continue to be assessed, whereas had the goal been reached their assessments might have been diminished, if not eliminated. Thus, rather than accomplish a reduction in the fees paid by the customers of these broker-dealers, expenses incurred by the broker-dealers would continue to be passed on to their customers.

In sum, the common law principle of equitable subrogation, the provisions of SIPA and of the 1934 Act, the well established rules of statutory construction, the Congressional intent underlying SIPA, and considerations of public policy, *all* militate against any conclusion that SIPC is not subrogated to the Section 17 claims which Weis' customers could have asserted against Touche Ross had their claims not been satisfied through the depletion of the SIPC fund. Therefore, it should come as no surprise that the Third Circuit just recently concluded that ". . . upon payment to a customer, SIPC becomes subrogated to the customer's rights against third parties. *Securities & Exchange Commission* v. *Albert Maguire Securities Co.*, CCH Fed. Sec. L. Rep. ¶ 96,129, p. 92,076 (July 27, 1977).

In view of the clear purpose of Section 17 to protect the customers of broker-dealers and given that SIPC is subrogated to their claims against Touche Ross, a Section 17 right of action should be implied for SIPC as the subrogee of Weis' customers.

POINT III

In contending that the purchaser-seller requirement of Section 18 must be satisfied by parties seeking a remedy under Section 17, Touche Ross erroneously takes a one-sided view of a two-sided statute.

Touche Ross makes a great deal of the fact that neither SIPC nor its subrogors (*i.e.*, Weis' customers) can satisfy the purchaser-seller requirement of Section 18, and on that basis Touche Ross contends that they may not obtain a remedy under Section 17. But Touche Ross simply fails to come to grips with the central premise that Section 17 was intended to protect investors in their capacity as the customers of broker-dealers, not in their capacity as the purchasers or sellers of securities.

In effect, Touche Ross is saying that, even though Congress found it necessary to enact Section 17 in order to protect customers from the financially unsound broker-dealers to whom they might entrust their cash or securities, Congress intended those customers to have a right of action under Section 17 *only* if they purchased or sold securities issued by the broker-dealer itself.

While it is true that a remedy exists under Section 18 where the broker-dealer is also an issuer, to narrowly confine the availability of a remedy to that limited circumstance is to overlook the more prevalent context within which a Section 17 claim may arise. That context is one where a customer is lulled into entrusting his cash or securities to a broker-dealer on the basis of a representation of financial soundness in the latter's certified—but false—Section 17 reports. That is the context with which Congress was concerned in enacting Section 17. That is the context within which this case arises. And that is the context which Touche Ross asks this Court to ignore by con-

tending that the purchaser-seller requirement of Section 18 must be engrafted into Section 17.*

By lumping Sections 17 and 18 together, Touche Ross is both confused and distortive. Citing *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975), Touche Ross argues that it would be "anomalous" to judicially imply a right of action under Section 17(a) for persons who are not purchasers or sellers because the express remedy under Section 18(a) requires those invoking the latter Section to be purchasers or sellers (TR Br. 23-24). The conclusion reached by the Supreme Court in *Blue Chip* that "[i]t would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for *comparable* express causes of action" (emphasis added, 421 U.S. at 735-736) resulted from the following predicament confronting the Court: both Sections 10(b) and 18(a) of the 1934 Act were, on their face, addressed to the protection of purchasers or sellers of securities; yet only Section 18(a) provided for an express right of action, the right of action under Section 10(b) having been judicially implied; and, notwithstanding that Section 18(a) contained a stringent purchaser-seller requirement, it was urged upon the Court that Section 10(b) should not. No such predicament is created by Section 17(a) because, unlike both Sections 10(b) and 18(a), it is not intended to protect purchasers or sellers of securities. It is concerned with protecting the customers of broker-dealers. Consequently, it

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* In other words, the Section 17 reports serve one purpose for a person who might be interested in buying or selling the securities issued by a broker-dealer. Those reports serve an entirely different purpose for a person whose only interest is determining whether to buy or sell securities through a particular broker-dealer. Section 18 covers the first purpose; it is silent as to the second. For that reason, SIPC maintains that Section 18 has no relevance to Section 17 in the context of this case.

can *not* be said about Sections 17(a) and 18(a)—as was said in *Blue Chip* about Sections 10(b) and 18(a)—that those Sections are "comparable".

Touche Ross also errs by arguing, through the invocation of the *expressio unius* doctrine, that Section 18(a) provides the exclusive remedy for causes of action arising under Section 17(a) (TR Br. 21-23). In this connection, Touche Ross principally relies upon *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers* ("*Amtrak*"), 414 U.S. 453 (1974), which held that, where a statute expressly provides that a particular person or persons may enforce that statute, such a provision is exclusive.* Touche Ross analogizes the purchaser-seller requirement of Section 18(a) of the 1934 Act to Section 307(a) of the Amtrak Act, which provides that *only* the Attorney General and certain railroad employees may enforce that Act. The analogy is, of course, simply wrong. The 1934 Act's counterpart to the Amtrak Act's *narrow* Section 307(a) is not Section 18(a), which imposes liability in behalf of some plaintiffs for misleading statements made in some reports mandated by some of the sections of the 1934 Act. The counterpart of Section 307(a) is the 1934 Act's *broad* Section 27 (upon which jurisdiction is predicated in the case at bar), which permits *anyone* to enforce, through the federal courts, any liability or duty created by the 1934 Act.** Thus, once again, Touche Ross' attempt to link Section 18 to Section 17 fails.

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* The same holding was reached in the other case relied upon by Touche Ross: *SIPC* v. *Barbour*, 421 U.S. 412 (1975).

** By invoking the *expressio unius* doctrine, Touche Ross, in effect, contends that Section 18 impliedly abrogates Section 27 insofar as the enforcement of Section 17 is concerned. However, "[i]t is a cardinal principle of construction that repeals by implication are not favored." *United States* v. *Borden Co.*, 308 U.S. 188, 198 (1939). *See also, Securities & Exchange Commission* v. *Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943) (cited in this brief, at 13-14, *supra*). Even if there were some valid

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Moreover, the decisions which Touche Ross describes as "pertinent" (TR Br. 24-29) do not support its contention that Sections 17 and 18 must go hand-in-hand. As noted in SIPC's main brief, those cases merely hold that a right of action under Section 13 is subject to the purchaser-seller requirement of Section 18 (SIPC Br. 36). Because Section 13 is concerned only with reports which *issuers and certain purchasers of securities* are required to file, it naturally goes hand-in-hand with Section 18. But the concern of both Sections 13 and 18 with the protection of the purchasers and sellers of securities is not shared by Section 17—a section intended to protect the customers of broker-dealers.

Thus, much as it may try, Touche Ross cannot, in the context of this case, wed Section 17 to Section 18. They are not "comparable" and no "anomaly" is created by keeping them apart. Section 18 is not the "exclusive" means for enforcing Section 17 here; Section 27 is. And the mere fact that Sections 13 and 18 have a common concern does not mean that Section 17 shares in that concern, which it does not. Accordingly, Touche Ross' one-sided view of a two-sided statute is simply myopic.

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basis for invoking the *expressio unius* doctrine with respect to Section 18's effect on Section 17 (which there is not), *Joiner* teaches that the doctrine must defer to "generally expressed legislative policy." *Accord, Baird* v. *Franklin, supra,* at 245. And the pertinent legislative policy here is that which underlies the very enactment of Section 17, *viz.*, that the customers of broker-dealers should be protected as such, irrespective of whether they buy or sell securities issued by the broker-dealer or by anyone else.

POINT IV

Section 17 imposes a duty on Touche Ross and Touche Ross is subject to liability for its violation of that duty.

Touche Ross contends that Section 17(a) and Rule 17(a)-5 thereunder impose "no duty" on accountants such as itself (TR Br. 63-64). That contention is belied by Rule 17(a)-5 itself. And, under the established doctrine of statutory tort, Touche Ross is liable for its breach of duty.

As noted in SIPC's main brief, an accountant such as Touche Ross bears a grave responsibility under Section 17(a) because of its crucial role—prescribed by Rule 17(a)-5—in certifying the broker-dealer's Section 17 reports (SIPC Br. 26-30). Touche Ross attempts to escape from the duty imposed upon it by emphasizing that Section 17(a) itself does not mention accountants. That emphasis is misplaced. Section 17(a), as effective in 1972, provided that a broker-dealer such as Weis shall ". . . *make such reports, as the* [*SEC*] *by its rules and regulations may prescribe* as necessary or appropriate in the public interest or for the protection of investors." Rule 17(a)-5 came into existence pursuant to that enabling legislation. And subsections (g), (h) and (i) of that Rule specifically spell out what the *accountant* must do with respect to the Section 17 reports.

Thus, Section 17(a) and Rule 17(a)-5 thereunder do indeed impose a duty on Touche Ross. Under Section 27 of the 1934 Act, its violation of that duty is actionable in the District Court. The claims asserted against Touche Ross were therefore improperly dismissed by the court below.*

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* Touche Ross' assertion that no action can be maintained here because "the complaint does not allege the necessary scienter" is

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Being subject to a statutory duty, Touche Ross—by the doctrine of statutory tort—is subject to liability for its violation of that duty (SIPC Br. 40). As was long ago established by the Supreme Court in *Texas & Pacific Ry.* v. *Rigsby,* 241 U.S. 33, 39-40 (1916):

> *"A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied,* according to a doctrine of the common law expressed in 1 Com. Dig., *tit.* Action upon Statute (F), in these words: 'So, in every case, where a statute enacts, or prohibits a thing for the benefit of a person, he shall have a remedy upon the same statute for the thing enacted for his advantage, or for the recompense of a wrong done to him contrary to the said law.' . . . This is but an application of the maxim, *Ubi jus ibi remedium."* (emphasis added)

Since *Rigsby,* of course, the courts have repeatedly, and various sections of the Securities Acts, recognized that a breach of statutory duty gives rise to a right of action on behalf of the injured persons for whose benefit the statuted was enacted. *E.g., Baird* v. *Franklin,* 141 F.2d 238 (2d Cir. 1944), *cert. denied* 323 U.S. 737 (1944) (§ 6b of

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plainly erroneous (TR Br. 64-67). In the first place, the scienter requirement of *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976) was rooted in the "manipulation, deception, *etc.*" language and legislative history of Section 10(b) and Rule 10(b)-5 thereunder, and Section 17 has no such roots. In the second place, even if scienter were required under Section 17, *Hochfelder* did not define the term and thus left intact this Court's formulation, a formulation easily satisfied by the complaint's allegations. *See, Lanza* v. *Drexel & Co.,* 470 F.2d 1277, 1306 (2d Cir. 1973). Indeed, the allegations of "knew or should have known" (Comp. ¶¶ 60, 65, 80, 82) are in and of themselves sufficient for scienter purposes. *Weinberger* v. *Kendrick,* 432 F.Supp. 316, 319-20 (S.D.N.Y. 1977).

1934 Act); *Goldstein* v. *Groesbeck*, 142 F.2d 422 (2d Cir. 1944), *cert. denied* 323 U.S. 737 (1944) (§ 4a of Public Utility Holding Company Act of 1935); *Kardon* v. *National Gypsum Co.*, 69 F.Supp. 512 (E.D. Pa. 1946) (§ 10b of 1934 Act); *Osborne* v. *Mallory*, 86 F.Supp. 869 (S.D.N.Y. 1949) (§ 17 of 1933 Act); *Hawkins* v. *Merrill, Lynch, Pierce, Fenner & Beane*, 85 F.Supp. 104 (W.D. Ark. 1949) (§§ 10b, 11a, 17a of 1934 Act); *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951) (§ 10b of 1934 Act); *Dann* v. *Studebaker-Packard Corp.*, 288 F.2d 201 (6th Cir. 1961) (§ 14a of 1934 Act); *Reader* v. *Hirsch & Co.*, 197 F.Supp. 111 (S.D.N.Y. 1961) (§ 7 of 1934 Act); *Brown* v. *Bullock*, 194 F.Supp. 207 (S.D.N.Y. 1961), *aff'd* 294 F.2d 415 (2d Cir. 1961) (§§ 15a and b of Investment Company Act of 1940); *Kroese* v. *Crawford*, CCH Fed. Sec. L. Rep. ¶ 91,262 (S.D.N.Y. 1963) (§ 16a of 1934 Act); *Franklin Nat. Bank* v. *L.B. Meadows & Co.*, 318 F.Supp. 1339 (E.D.N.Y. 1970) (§ 15c of 1934 Act); *Kerber* v. *Kakos*, 383 F.Supp. 625 (N.D. Ill. 1974) (§ 12g of 1934 Act).

Consequently, Section 17 not only imposes a duty on Touche Ross, but Touche Ross is liable thereunder to those who are protected by that Section—namely, SIPC and Weis' customers, to whose claims SIPC is subrogated.

CONCLUSION

For the foregoing reasons, the order and judgment appealed from should be reversed in all respects.

Respectfully submitted,

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375—Affidavit of Service

United Stated Court of Appeals
For the Second Circuit

The Reporter Co., Inc., 11 Park Place, New York, N. Y. 10007

Edward S. Re dington et al.

Plaintiffs-Appellants

against

Touche Ross & Co.

Defendant-Appellee

AFFIDAVIT OF SERVICE

STATE OF NEW YORK,
COUNTY OF New York , ss:

Raymond J. Braddick, agent for Hawkins Delafield & Wood Esqs. being duly sworn, deposes and says that he is over the age of 21 years and resides at 11 Park Place New York

That on the 25th. day of October 1977 at see attached list he served the annexed Reply Brief upon see attached list in this action, by delivering to and leaving with said attorneys 3 true copys thereof.

DEPONENT FURTHER SAYS, that he knew the person so served as aforesaid to be the person mentioned and described in the said actiion

Deponent is not a party to the action.

Sworn to before me, this 25th.
day of October 19 77

Raymond J. Braddick

ROLAND W. JOHNSON
Notary Public, State of New York
No. 4509705
Qualified In Delaware Count
Commission Expires March 30, 1979

Copy Received
Date.....
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